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In the Supreme Court of the United States

OCTOBER TERM, 1944

No. 1295

CLARION OIL COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (R. 13–26) is reported at 1 T. C. 751. The opinion of the Court of Appeals for the District of Columbia (R. 28–36) has not been reported.

JURISDICTION

The judgment of the court of appeals was entered on March 12, 1945 (R. 37). The petition for a writ of certiorari was filed on May 21, 1945. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether a cash bonus received by the transferor of an interest in an oil and gas lease constitutes personal holding company income within the meaning of Section 353 of the Revenue Act of 1936, as amended by Section 1 of the Revenue Act of 1937.

STATUTES AND REGULATIONS INVOLVED

The relevant provisions of the Statutes and Regulations involved are set forth in the Appendix, *infra*.

STATEMENT

The facts were found by the Tax Court as stipulated by the parties (R. 15–18). The findings pertinent to the issue presented by the taxpayer's petition for certiorari are as follows:

The taxpayer is a corporation organized under the laws of Texas in 1911, more than 50 percent in value of its outstanding stock being owned by not more than five individuals during the taxable year 1937 (R. 15). The taxpayer was not a "personal holding company" in any year before 1937 (R. 18).

Prior to 1937, the taxpayer acquired, by assignment, an undivided three-fourths of the lessee's (or working) interest in an oil, gas and mineral lease dated April 6, 1933, and covering certain property located in Texas (R. 15). The lease provided for a royalty of one-eighth of the oil, gas

and casinghead gas produced and also provided for maintaining the lease in effect for a period of five years by the payment of a cash rental (R. 15–16). Under its terms, the lease was to lapse on November 30, 1938, unless production was then taking place or drilling operations were then in progress (R. 16). No drilling or production had taken place prior to July 3, 1937. On that date the taxpayer and the other owners of the lessee's interest assigned the lease to the Humble Oil and Refining Company for a cash bonus of $160,000, of which $120,000 was received by taxpayer in 1937 as its share, and in further consideration of an overriding royalty of 1/24th of the production, and a further payment out of production until the aggregate amount equalled $320,000 (R. 16).

After acquiring the lease, the Humble Oil and Refining Company drilled but failed to obtain production and abandoned the well in the middle of 1938. No production having been obtained, and no drilling being in progress on that date, the lease expired by its own terms on November 30, 1938 (R. 16).

The taxpayer's gross income for 1937 consisted of the following items (R. 19):

Dividends and interest	$75,155.38
Rents	1,335.56
Oil royalties	52,160.71
Cash bonus	120,000.00
Total	248,651.65

The taxpayer included the $120,000 cash bonus as taxable income for 1937 and took a deduction

for depletion thereon in the amount of $33,000 (R. 16–17). The Commissioner determined that the cash bonus constituted personal holding company income under Section 353 of the Revenue Act of 1936, as amended by Section 1 of the Revenue Act of 1937, as constituting either "rents" under Section 353 (g) or "royalties" under Section 353 (h). Since the other requirements of the statute were met, the Commissioner determined that the taxpayer was subject to the surtax on its undistributed adjusted net income under Section 351 of that Act, as so amended (R. 8–9).

The Tax Court held that the bonus payment was neither "rents" nor "royalties" and that, therefore, the taxpayer was not subject to the surtax (R. 20–22). On review, the court below reversed the Tax Court in this respect, construing the term "royalties" as including a cash bonus paid in these circumstances; the court agreed with the Tax Court that the cash bonus did not constitute "rents" (R. 28–32).

ARGUMENT

1. The decision of the court below upon this question[1] is correct and further review by this Court is not warranted. A bonus received for transferring a working interest in an oil and gas lease, when an economic interest is retained by the

[1] The Commissioner is filing a cross-petition for a writ of certiorari with respect to another question decided by the court of appeals.

transferor in the oil and gas in place, has long been regarded as an advance royalty to the transferor. *Burnet* v. *Harmel,* 287 U. S. 103; *Murphy Oil Co.* v. *Burnet,* 287 U. S. 299; *Bankers Pocahontas Coal Co.* v. *Burnet,* 287 U. S. 308; *Herring* v. *Commissioner,* 293 U. S. 322; cf. *Anderson* v. *Helvering,* 310 U. S. 404, 409. A bonus in such circumstances has not only been considered as "the gross income from the property" on which depletion is allowed, but has also been regarded as ordinary income taxable as such to the recipient. *Burnet* v. *Harmel, supra; Murphy Oil Co.* v. *Burnet, supra.* This Court has characterized a bonus as an advance royalty or rental even when that term was used in a statute unrelated to taxation. *Work* v. *Mosier,* 261 U. S. 352.

The enactment of the surtax on undistributed personal holding company income was designed to close up a gap in the taxing scheme whereby notorious tax evasion and avoidance were achieved by the device of personal holding companies or "incorporated pocketbooks." H. Doc. No. 337, 75th Cong., 1st Sess.; H. Rep. No. 1546, 75th Cong., 1st Sess. (1939–1 Cum. Bull. (Part 2) 704); S. Rep. No. 1242, 75th Cong., 1st Sess. (1939–1 Cum. Bull. (Part 2) 703). When Congress defined personal holding company income in terms of "mineral, oil, or gas royalties" in Section 353 (h) of the Revenue Act of 1936, as amended by Section 1 of the Revenue Act of 1937 (Appendix, *infra*), it must have used that term in the sense in which it

has been employed by this Court. Certainly, it would have been contrary to the purpose of this remedial legislation to have excluded from its scope one type of oil and gas income which, for tax purposes, cannot be distinguished from another kind (a continuing share in production) which, admittedly, was covered. There is nothing in the legislative history of the enactment evidencing an intent to treat cash bonuses, which are regarded as advance royalties, any differently than royalties which are paid as production takes place.

It may be noted that Congress has specifically exempted corporations which are engaged in an actual business and which have income of this type. Thus, Section 353 (h) provides that mineral, oil or gas royalties shall not constitute personal holding company income if they constitute 50 percent or more of the company's gross income and the deductions allowable as business expenses under Section 23 (a) (other than compensation for personal services rendered by shareholders) constitute 15 percent or more of its gross income.

2. The issue raised by the taxpayer presents only one question, namely, the correct statutory interpretation of the term "royalties." The decision below does not, as asserted (Pet. 12–13), depart from *Dobson* v. *Commissioner,* 320 U. S. 489, rehearing denied, 321 U. S. 231. Where a pure matter of statutory construction is involved,

the determination of congressional meaning is not a matter exclusively committed to the authority of the Tax Court. *Security Mills Co.* v. *Commissioner,* 321 U. S. 281; *Dixie Pine Co.* v. *Commissioner,* 320 U. S. 516; *Helvering* v. *Amer. Dental Co.,* 318 U. S. 322; *Trust U/W of Mary Lily (Flagler) Bingham* v. *Commissioner,* No. 932, this term, decided June 4, 1945.[2] Moreover, the legislative history of the procedure for appellate review of Tax Court decisions clearly demonstrates that Congress specifically intended that circuit courts of appeals "upon review may consider, for example, questions as to * * * the proper interpretation and application of the statute or any regulation having the force of law * * *." H. Rep. No. 1, 69th Cong., 1st Sess., pp. 19–20 (1939–1 Cum. Bull. (Part 2) 315); S. Rep. No. 52, 69th Cong., 1st Sess., p. 36 (1939–1 Cum. Bull. (Part 2) 332).

3. No conflict in decisions is presented. The question which the taxpayer seeks to bring before this Court is not of sufficient importance to warrant further review by this Court. However, if certiorari is granted, the Commissioner will re-

[2] It may be suggested that the Tax Court's interpretation of the term "royalties", a term of general application in the field of oil and gas law, would be reviewable by the courts even under the concurring opinion of Mr. Justice Frankfurter in the *Bingham* case, as being "outside the special province of the Tax Court." Slipsheet opinion (concurring), p. 4.

new the alternative contention made below that the bonus received constitutes "rents" under Section 353 (g) (Appendix, *infra*).

CONCLUSION

The decision of the court below is correct. There is no conflict of decisions and no question of importance is presented. Accordingly, the petition for a writ of certiorari should be denied.

Respectfully submitted,

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JUNE 1945.